



CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

October 28, 2005

Reconciliation Recommendations of the House Committee on Financial Services

*As approved by the House Committee on Financial Services
on October 27, 2005*

SUMMARY

Subtitle A of the legislation would amend laws governing banks and credit unions to modify the deposit insurance system. It would restructure the insurance funds administered by the Federal Deposit Insurance Corporation (FDIC), change the terms and conditions under which banks and savings associations pay insurance premiums, and increase insurance coverage for some of the accounts insured by the FDIC and the National Credit Union Administration (NCUA).

Subtitle B would make spending for certain activities associated with the sale of multifamily properties in the Federal Housing Administration's (FHA's) inventory of defaulted mortgages subject to appropriation for fiscal years 2006 through 2010. FHA currently spends about \$60 million a year performing those activities.

CBO estimates that enacting this legislation would reduce direct spending by \$470 million over the 2006-2010 period and by \$2.8 billion over the 2006-2015 period. Most of the savings would result from the changes in deposit insurance in subtitle A, particularly provisions giving the FDIC more flexibility in determining the size of the Deposit Insurance Fund and setting the premiums to be paid by banks and thrifts.

The legislation contains an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates it would impose minimal costs, if any, on state, local, or tribal governments. Those costs would not exceed the threshold established in UMRA (\$62 million in 2005 adjusted annually for inflation).

This bill contains private-sector mandates, as defined in UMRA, primarily because the deposit insurance provisions (Subtitle A) would result in certain depository institutions paying higher premiums for federal deposit insurance. Subtitle B of the bill contains no private-sector mandates. Although CBO cannot determine the aggregate cost of all of the

private-sector mandates in the bill, we expect that the direct cost of those mandates would exceed the annual threshold established by UMRA (\$123 million in 2005, adjusted annually for inflation) in most of the first five years the mandates are in effect.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of the legislation is shown in the following table. The savings from this legislation fall within budget function 370 (commerce and housing credit).

By Fiscal Year, in Millions of Dollars												
2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2006- 2010	2006- 2015	
CHANGES IN DIRECT SPENDING												
Subtitle A: Deposit Insurance												
Changes in Costs to Resolve Failed Institutions Insured by FDIC and NCUA												
Estimated Budget Authority	0	0	0	0	0	0	0	0	0	0	0	0
Estimated Outlays	0	100	100	100	100	100	200	200	200	300	400	1,400
Changes to FDIC and NCUA Premium Collections												
Estimated Budget Authority	0	0	0	0	0	0	0	0	0	0	0	0
Estimated Outlays	0	-200	-300	100	-200	-700	-700	-700	-700	-500	-600	-3,900
Subtitle B: Federal Housing Administration												
Termination of Certain FHA Multifamily Authorities												
Estimated Budget Authority	-30	-60	-60	-60	-60	0	0	0	0	0	-270	-270
Estimated Outlays	-30	-60	-60	-60	-60	0	0	0	0	0	-270	-270
Total Changes Under Legislation												
Estimated Budget Authority	-30	-60	-60	-60	-60	0	0	0	0	0	-270	-270
Estimated Outlays	-30	-160	-260	140	-160	-600	-500	-500	-500	-200	-470	-2,770
NOTES: FDIC = Federal Deposit Insurance Corporation; FHA = Federal Housing Administration; NCUA = National Credit Union Administration.												

BASIS OF ESTIMATE

This estimate assumes that the legislation will be enacted before the end of calendar year 2005.

Deposit Insurance

Two federal agencies are primarily responsible for the deposit insurance system. The FDIC insures the deposits in banks (financed through the Bank Insurance Fund, BIF) and thrift institutions (financed through the Savings Association Insurance Fund, SAIF). The NCUA insures the deposits in credit unions (referred to as shares) with the Share Insurance Fund. When financial institutions fail, the FDIC and NCUA use the insurance funds to reimburse the insured depositors of the failed institutions. These agencies then sell the assets of the institutions and deposit any money recovered into the insurance funds.

The legislation would increase insurance coverage from \$100,000 to \$130,000 for standard accounts and to twice the standard amount for retirement accounts (\$260,000); coverage for municipal deposits would rise to the lesser of \$2 million or the sum of the standard coverage plus 80 percent of any amounts above that level. The standard coverage limit for insured deposits would be adjusted in 2008 and every five years thereafter to account for inflation; those future adjustments would be based on the rate of inflation in preceding years, as measured by the Personal Consumption Expenditures Chain-Type Index, and would be rounded to the nearest \$10,000. The legislation would merge the BIF and the SAIF to create a new Deposit Insurance Fund (DIF). Other provisions would give the FDIC more flexibility in determining the appropriate size of the insurance fund and in setting the premiums to be paid by banks and thrifts.

CBO estimates that increasing deposit insurance coverage to the levels specified in the legislation would increase the net cost of resolving failed institutions by about \$1.4 billion over the next 10 years. CBO also expects that the FDIC would use its new authority to collect about \$3.8 billion more in net assessments than CBO estimates would be collected under current law. Over the same period, we estimate that NCUA would increase its net assessments by about \$0.1 billion under the legislation. As a result, CBO estimates that the legislation would reduce net direct spending of the FDIC and NCUA by \$0.2 billion over the 2006-2010 period and by \$2.5 billion over the 2006-2015 period.

Increase in the Cost of Resolving Failed Financial Institutions. By insuring some current deposits that are now uninsured, the legislation would increase the liability of the FDIC and NCUA when institutions fail, without significantly increasing the assets of those institutions. Under current law, CBO estimates that the FDIC's insured deposits will total \$3.8 trillion by

the end of 2006 and that its net losses on failed institutions will total about \$8.4 billion over the 2006-2015 period. (We project that gross losses of \$38.6 billion would be offset, in part, by recoveries of \$30.2 billion from selling the assets of the failed institutions over the 10-year period.)

Under this legislation, CBO estimates that deposit insurance coverage for most accounts would total \$130,000 through 2012 and increase to \$150,000 in 2013; the coverage levels for retirement accounts and in-state municipal deposits would be much higher. At those levels, CBO estimates that deposits insured by the FDIC would increase by about 8 percent by 2007, or by about \$330 billion. We estimate this change in the amount of insured deposits would lead to a net increase in losses of \$1.4 billion over the next 10 years, mostly for the FDIC.

Effects on Premiums Paid to the FDIC By Financial Institutions. Three provisions of the legislation would affect the total amount of premiums collected by the FDIC. The legislation would allow the reserve ratio for the DIF to range between 1.15 percent and 1.4 percent—it currently is fixed at 1.25 percent—and would give the FDIC flexibility in setting the premiums needed to achieve the desired level. (The reserve ratio is calculated by dividing the amount in the fund by the amount of insured deposits.) Second, some financial institutions would be given one-time credits that could be used to pay the FDIC premium assessments in lieu of cash. Finally, the legislation would require the FDIC to merge the BIF and the SAIF. Overall, CBO estimates that the net effect of these provisions on deposit insurance premiums would be an increase in collections of about \$3.8 billion over the next 10 years. The major provisions that would affect premium assessments are described below.

Increased FDIC Discretion Over the Reserve Ratio and Premiums. For this estimate, CBO assumes that the FDIC would initially adopt a reserve ratio close to the current level of 1.25 percent, but would allow the ratio to vary around that target depending on the outlook for losses and factors that affect the insurance fund. We also expect that the FDIC would attempt to limit volatility in premiums by setting the fees at levels considered likely to achieve the desired reserve ratio over several years. CBO expects that the FDIC would choose to charge all institutions some premiums all of the time because even the strongest institutions pose some risk. (Under current law, the vast majority of institutions do not pay any premiums if reserves of the BIF or the SAIF are greater than 1.25 percent of insured deposits.) Based on information from the FDIC, CBO expects that the existing category of least risky institutions—which currently account for 98 percent of assessable deposits—would be subdivided into three groups.

Assuming an initial target reserve ratio of about 1.25 percent, CBO expects that the lowest-risk group would be assessed at a base rate of 0.01 percent and that institutions in higher-risk categories would pay higher rates. CBO also expects, however, that the FDIC would have to levy additional premiums to offset the drop in the DIF reserve ratio that would result from

the higher levels of insurance coverage specified in the legislation. (CBO estimates that the increase in insured deposits would reduce the reserve ratio by about 10 basis points.) For this estimate, CBO assumes that the FDIC would opt to rebuild the reserve gradually to avoid sharp swings in premiums. Because the legislation would cap the premiums paid by the strongest institutions at 0.01 percent of their deposits, any additional premiums would have to be paid by institutions in the higher-risk categories.

Other provisions would limit the FDIC's flexibility in setting premiums if the DIF's reserves fall below or above the 1.15 percent to 1.4 percent range. For example, it would direct the FDIC to pay varying levels of dividends to insured institutions if the reserve ratio exceeds 1.35 percent. If the reserve ratio were to fall below 1.15 percent of insured deposits, the legislation would require the FDIC to implement a restoration plan to bring the ratio back to 1.15 percent within 10 years. Such restrictions could affect the amount or timing of premiums collected by the FDIC under some conditions, but their net effect would not be significant under CBO's current projections of the growth of insured deposits and losses, adjusted for the impact that the one-time credits would have on premium income.

Under such assumptions, CBO estimates that the FDIC's premium assessments—before the use of premium credits—would total \$18.1 billion over the 2006-2015 period, compared to about \$9.1 billion under current law. Because of the time needed to implement these changes, CBO assumes the new premium levels would not take effect until fiscal year 2007. The amounts paid by most banks and savings associations would be reduced by the availability of one-time premium credits authorized by the legislation (see below).

Credits for Future Premiums. The legislation would require the FDIC to provide certain banks and thrifts with one-time credits against future premiums, based on the amount of their payments to the BIF or SAIF prior to 1997. The credits would equal 12 basis points (0.12 percent) of the combined assessment base of the BIF and SAIF as of December 31, 2001, or a total of \$5.4 billion. CBO estimates that eligible institutions would use \$5.2 billion of the credits over the 2006-2015 period.

After adjusting for such credits, CBO estimates that implementing this legislation would increase net proceeds from premiums by a total of \$3.8 billion relative to CBO's baseline over the next 10 years. Under CBO's current baseline assumptions regarding deposit growth and bank failures, the premium collections net of credits would result in an average reserve ratio of about 1.20 over the 2007-2015 period.

Merging BIF and SAIF. The legislation would require the FDIC to merge the Bank Insurance Fund and the Savings Association Insurance Fund and create a new Deposit Insurance Fund. When considered together with the other reforms in the legislation, CBO expects that merging the funds would have a negligible budgetary impact.

Increase in Premiums Paid to NCUA By Financial Institutions. Credit unions are required to pay NCUA 1 percent of the net change in deposits each year. Thus, increasing the amount of insured deposits would increase the amounts collected by the NCUA. Based on information on the characteristics of credit union deposits, CBO expects that the legislation would extend insurance coverage to about \$8 billion in currently uninsured deposits by 2007. Thus, CBO estimates that NCUA's net premium collections would increase by about \$100 million over the 2006-2015 period, most of which would be received over the 2006-2010 period.

Amending Authority for Certain FHA Multifamily Activities

Under subtitle B of this legislation, FHA's mandatory spending authority for rehabilitation grants and below-market sales would be suspended for fiscal years 2006 through 2010. Those activities could continue only if appropriations were provided to finance them over that period. Under current law FHA has the authority to undertake these activities for properties financed by loans insured prior to 1992, using its permanent funding authority from the General and Special Risk Insurance Fund liquidating account. CBO estimates that these provisions would reduce direct spending by \$30 million in 2006 and \$270 million over the 2006-2010 period.

FHA often provides rehabilitation grants to purchasers when selling multifamily properties in the agency's inventory of defaulted properties. Based on the historical amount of those grants, CBO estimates that making them subject to appropriation would reduce direct spending by about \$20 million in 2006 and \$50 million annually over the 2007-2010 period.

To preserve a defaulted property as affordable housing, FHA may sell that property at below-market rates. Based on information from FHA, CBO estimates that the forgone proceeds associated with these sales average about \$10 million annually. Enacting this legislation would end FHA's permanent authority to sell such properties at below-market prices over the 2006-2010 period. CBO expects that the resulting increase in sales receipts would average about \$10 million annually over the next five years. Under this legislation FHA could continue to sell properties at below-market prices over the next five years if funds are appropriated in advance to the agency in amounts sufficient to offset forgone sales receipts.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

The legislation contains an intergovernmental mandate as defined in UMRA. A provision in section 4003 would preempt New York state laws that bar savings banks and savings and loan associations from accepting municipal deposits. Complying with this mandate would

impose minimal costs, if any, on the state of New York, and any such costs would not exceed the threshold established in UMRA (\$62 million in 2005 adjusted annually for inflation). Enacting section 4003 could benefit municipalities in New York to the extent that more depository institutions may compete for their deposits and offer more favorable terms as part of that competition.

Other provisions of the legislation contain no mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

The legislation contains private-sector mandates, as defined in UMRA, primarily because it would require certain depository institutions to pay higher premiums for federal deposit insurance. CBO estimates that the direct cost of those mandates would exceed the annual threshold in UMRA (\$123 million in 2005, adjusted annually for inflation) in most of the first five years the mandates are in effect. We do not have sufficient information to provide an estimate of the aggregate cost of all the mandates in the legislation.

Banks and Savings Associations

Commercial banks and savings associations must have federal deposit insurance. Changes in the federal deposit insurance system that increase requirements on those institutions are therefore private-sector mandates under UMRA. Specifically, the legislation would increase federal insurance coverage for certain insured depository accounts. It would increase coverage for standard accounts from \$100,000 to \$130,000, increase coverage for retirement accounts to twice the standard coverage amount (from \$100,000 to \$260,000), increase coverage for in-state municipal deposit accounts, and direct the FDIC to increase the standard coverage level to adjust for inflation every five years. Because premiums are based in part on the amount of insured deposits, an increase in coverage would require banks and savings associations to pay more in deposit insurance premiums.

Three additional provisions of the legislation would affect the total amount of premiums collected by the FDIC. First, it would require the FDIC to merge the BIF and the SAIF insurance funds. Second, it would provide the FDIC with greater discretion to set premiums by allowing the agency to collect premiums from all banks and savings institutions regardless of their risk category. Under current law, banks and savings associations in the lowest risk category do not have to pay any deposit insurance premiums when their deposit insurance fund (BIF or SAIF) is above a designated reserve ratio of 1.25 percent of insured deposits.

Third, the legislation would direct the FDIC to grant credits to some financial institutions that could be used to pay deposit insurance premiums in lieu of cash.

CBO estimates that banks and savings associations would pay (net of credits) about \$1.1 billion more in premiums over the 2007-2011 period relative to current law. The incremental cost to the industry would depend, in part, on how the FDIC would use its new discretion under the bill to set premium rates. For this estimate, CBO assumes that the FDIC would begin to collect premiums from banks and savings associations that are not required to pay premiums under current law.

Credit Unions

Because the legislation also would increase the coverage of insured accounts for federally insured credit unions, those credit unions would have to contribute more to the National Credit Union Insurance Fund. CBO estimates that those additional contributions would total about \$100 million over the 2007-2011 period. All federally chartered and most state-chartered credit unions are required to have federal share (deposit) insurance. According to the National Association of Federal Credit Unions, 17 states do not require their state-chartered credit unions to purchase federal share insurance. The cost of the mandate would amount to the incremental premiums paid by those institutions required to have federal insurance and thus may be less than the total additional contributions collected from all federally insured credit unions.

Employee Benefit Plan Deposits

The bill also would prohibit banks, savings associations, and credit unions that are not well capitalized or adequately capitalized from accepting deposits for employee benefit plans. CBO does not have sufficient information to assess the cost of this mandate.

PREVIOUS CBO ESTIMATE

On October 24, 2005, CBO transmitted a cost estimate for the reconciliation recommendations of the Senate Committee on Banking, Housing, and Urban Affairs, as approved by that committee on October 18, 2005, with a subsequent amendment provided to CBO on October 21, 2005. The estimated net costs of the deposit insurance provisions in the House and Senate Committee versions are similar despite differences in some provisions, such as the level of deposit insurance coverage and the amount of one-time credits that FDIC-insured institutions can apply against future premium payments. Net outlays over the

2006-2010 period would be about \$100 million lower under the Senate Committee's legislation, primarily because that version would provide a smaller amount of one-time credits for banks and thrifts.

The House legislation would make spending for certain activities associated with the sale of multifamily properties in FHA's inventory of defaulted mortgages subject to appropriation for fiscal years 2006 through 2010. In contrast, the Senate legislation would permanently end those spending authorities and authorize the appropriation of \$100 million in 2006 to finance them.

ESTIMATE PREPARED BY:

Federal Costs: Kathleen Gramp and Susanne S. Mehlman;
Judith Ruud

Impact on State, Local, and Tribal Governments: Sarah Puro

Impact on the Private Sector: Judith Ruud and Paige Piper/Bach

ESTIMATE APPROVED BY:

Robert A. Sunshine
Assistant Director for Budget Analysis